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Nos. 86-219, 86-224, 86-225 and 86-226

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1986

SOUTHERN UNION COMPANY, PETITIONER

v.

JICARILLA APACHE TRIBE, ET AL.

SOUTHLAND ROYALTY COMPANY, PETITIONER

v.

JICARILLA APACHE TRIBE, ET AL.

EXXON CORPORATION, PETITIONER

v.

JICARILLA APACHE TRIBE, ET AL.

UNICON PRODUCING COMPANY, PETITIONER

v.

JICARILLA APACHE TRIBE, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECRETARY OF THE INTERIOR IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that petitioners, which produce natural gas on the Jicarilla Apache Reservation under lease agreements with the Tribe, are obligated to pay the Tribe royalties under a "dual accounting" method.

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OPINIONS BELOW

The opinion of the en banc court of appeals (Pet. App. 1a-14a)[1] is reported at 782 F.2d 855, and the supplemental opinion of the en banc court (Pet. App. 18a-19a) is re-

[1] "Pet. App." refers to the joint petition appendix filed in No. 86-219.

ported at 793 F.2d 1171. The opinion of the three-judge panel of the court of appeals (Pet. App. 21a-65a) is reported at 728 F.2d 1555. The district court's opinion (Pet. App. 104a-137a) is reported at 479 F. Supp. 536.

JURISDICTION

The judgment of the court of appeals was entered on January 23, 1986 and petitions for rehearing were denied on April 15, 1986 (Pet. App. 15a-16a). Justice White extended the time for filing the petitions for a writ of certiorari to August 13, 1986 and the petitions were filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Jicarilla Apache Tribe occupies a 742,315 acre Executive Order reservation in northwestern New Mexico. Since the early 1950's, the Tribe has leased reservation land for oil and gas production. The leases, which have been approved by the Secretary of the Interior, are governed by the provisions of a standard lease form entered into pursuant to federal statutes and regulations. See Indian Mineral Leasing Act (IMLA), 25 U.S.C. 396a-396g; 25 C.F.R. Pt. 211.[2]

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[2] The IMLA was enacted in 1938 to provide a uniform statutory scheme for Indian tribes to lease unallotted lands for mining purposes. See S. Rep. 985, 75th Cong., 1st Sess. 3 (1937); see generally *Montana* v. *Blackfeet Tribe of Indians*, No. 83-2161 (June 3, 1985). The statute provides that unallotted lands within Indian reservations may, with the approval of the Secretary, be leased for mining purposes, by authority of the authorized spokesmen for the Tribe (25 U.S.C. 396a). The statute also provides that lessee operations affecting restricted Indian lands shall be subject to rules and regulations promulgated by the Secretary (25 U.S.C. 396d). See 25 C.F.R. Pt. 211. Those regulations are incorporated in the lease agreements here. See Pet. App. 382a.

In May 1975, the Tribe brought suit against petitioners, contending that their conduct breached the lease agreements and violated the antitrust laws. Of particular relevance here, the Tribe claimed that petitioners had failed to develop their leases diligently, had failed to drill offset wells to protect the leases from drainage, and had failed to account properly for royalties. The Tribe specifically argued that the leases required petitioners to pay royalties based on a "dual accounting" method.[3] The Tribe later named the Secretary of the Interior as a defendant, claiming that the Secretary had failed to ensure that petitioners performed their lease obligations and had thereby breached fiduciary duties owed to the Tribe. Pet. App. 104a-105a, 108a-109a, 117a.

The district court rejected the Tribe's claims that petitioners had failed to develop the leases (Pet. App. 120a) and protect against drainage (*id.* at 124a), but concluded that the Secretary should have engaged in more rigorous monitoring of the lessees' activities to ensure diligent development and drainage protection (*ibid.*). Turning to the Tribe's challenge to petitioners' accounting method, the court stated that "where, as here, gas produced from

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[3] The leases provide that royalties shall be paid as a percentage of the "value" of the gas produced. See Pet. App. 379a. Industry practices provide a number of accounting methods for determining value, including the "BTU adjustment" method and the "net realization" method. Under the BTU adjustment method, value is determined on the basis of the wellhead sales price of the unprocessed natural gas, adjusted to reflect the heating value of the gas. Under the net realization method, value is determined on the basis of the sales price of the individual components of the natural gas, adjusted to reflect the costs of separating and processing those components. Under "dual accounting," the lessee accounts for the value of the natural gas using both accounting methods and then calculates and pays royalties based on the higher of the two values. Prior to the sharp increase in oil prices in the 1970's, the BTU adjustment method, then used by petitioners without objection from the Secretary, provided the higher royalties.

the lease is processed into component products, dual accounting is required by the terms of the lease. Accordingly, the Secretary had the obligation to require [petitioners] to account on the net realization method" (*id.* at 131a). The district court ordered the Secretary to require the petitioners to render an accounting by the "dual accounting method for the years 1970 to the present" (*id.* at 135a) and to submit the accounting to the district court for its approval. The district court ultimately ordered petitioners to pay the Tribe $343,738.81 in royalties.

On appeal, petitioners challenged the district court's determination that the Tribe was entitled to receive royalties under the dual accounting method. The Secretary urged that he had not violated fiduciary duties owed to the Tribe but did not challenge the district court's determination that dual accounting is required. The Tribe challenged other aspects of the district court's ruling.

The court of appeals panel reversed the district court's determination that the Tribe is entitled to dual accounting. The court stated that "[f]rom 1950 to 1979 without exception, and without variation, the Secretary and the USGS [United States Geological Survey] had construed the lease provisions and [Interior's leasing] regulations to require dual accounting not by all lessees, but *only* in instances where the lessee owned the processing plant (or received added money for its products)" (Pet. App. 24a (emphasis in original)). The court concluded that "[t]he original construction placed on the lease and regulations by the Secretary as to this issue must be applied to and through the conclusion of these proceedings" (*id.* at 29a). The court found "no basis for the trial court's determination as to fiduciary standards" and declined to decide "whether or not the Secretary owes the tribe a fiduciary duty as to the matters under consideration" (*id.* at 30a).

Judge Seymour dissented, concluding that dual accounting should be required. She noted that the Secretary now agreed with the district court that dual accounting should be used (Pet. App. 42a-43a). Concluding that the Secretary owes fiduciary duties to the Tribe, she stated "the true issue in this case is not whether the Secretary's earlier application of the royalty terms was reasonable; rather, it is whether the alternative interpretation requiring dual accounting is also reasonable *and* better promotes the Tribe's interest" (*id.* at 45a (emphasis in original)). She concluded that either interpretation of the lease and Interior regulations, requiring or not requiring dual accounting, would be reasonable, and that the Secretary's choice between these interpretations should be based on the alternative that provides the greatest benefits to the Tribe (*id.* at 48a).

The Tribe petitioned for rehearing en banc. The court of appeals granted the petition and reversed the panel decision, adopting Judge Seymour's dissent with minor modifications not relevant here (Pet. App. 3a-4a). The Secretary then moved for modification of the court's decision to delete that part of the opinion (*id.* at 41a-48a) discussing fiduciary duties, arguing that, because the Secretary had agreed to require dual accounting, the issue was moot. The court denied the motion (*id.* at 18a). However, the court, on its own motion, supplemented its en banc opinion to make clear that petitioners are liable for past nonpayment of royalties under the dual accounting method (*id.* at 18a-19a). The court stated (*id.* at 19a (footnote omitted)):

> While the Secretary failed in its duty to represent the Tribe's interests in the present case, the relationship between the Tribe and [petitioners] is contractual. The failure of the Secretary to require dual accounting resulted in the lessees paying an insufficient amount of royalties under the contract. That the Secretary breached [his] fiduciary duty to properly en-

force the leases does not excuse the lessees from subsequently having to pay the amounts determined to be owed under the leases. *Cf. Atlantic Richfield Co. v. Hickel*, 432 F.2d 587, 592 (10th Cir. 1970).

ARGUMENT

The court of appeals reasonably concluded that petitioners are obligated under their lease agreements to pay royalties on a dual accounting basis. That determination is consistent with the Secretary's present interpretation of the particular lease agreements at issue here, and it does not conflict with any decision of this Court or of other courts of appeals. The court incorrectly found that the Secretary, in the past, had breached fiduciary duties to the Tribe. However, the Tribe and the Secretary now agree on the proper method of calculating royalties in this case, and those royalties remain subject to collection under the lease agreements. Under these circumstances, the court's finding that the Secretary breached fiduciary duties has little remaining practical importance. Accordingly, this case does not warrant this Court's review.

1. Petitioners characterize this case as presenting important questions concerning the United States' fiduciary duties to the Nation's Indian tribes. However, this case, in its current posture, presents what is essentially a narrow contractual dispute between petitioners and the Jicarilla Apache Tribe. The court of appeals did discuss the Secretary's fiduciary duties to that Tribe, employing an analysis that we consider largely mistaken.[4] But whether or not that analysis is correct, it has only limited relevance

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[4] Assuming that the IMLA creates fiduciary obligations, we submit that the Secretary's conduct in these cases meets the "ordinarily prudent man" standard that the Claims Court has applied in Indian trust cases. See, *e.g., Navajo Tribe of Indians* v. *United States*, 9 Cl. Ct. 336, 400 (1986). Prior to the dramatic increase of oil and gas prices in

at this juncture. The Secretary presently agrees, quite apart from any fiduciary obligations that might exist, that dual accounting should be utilized in this case. There is no substantial difference between the position of the Secretary and the Tribe at this time and there is little to be gained from examining the question of fiduciary obligations in an abstract context at petitioners' behest, particularly when neither the Secretary nor the Tribe desires further review of this question.[5]

The focus of the present dispute is *petitioners'* obligations to the Tribe. The court of appeals correctly observed that "the relationship between the Tribe and [petitioners] is contractual (Pet. App. 19a), an observation with which all parties, including the Secretary, the Tribe (Br. in Opp. 24-25), and petitioners (86-219 Pet. 20; 86-226 Pet. 12, 14), agree. As the Tribe explains, petitioners "agreed to lease provisions reasonably susceptible to the interpretation that royalties be based on the highest value reasonably obtainable under their [leases]" (Br. in Opp. 24-25). The Tribe brought suit against petitioners, successfully urged its interpretation of the lease agreements' royalty provisions before the district court, and ultimately prevailed before the court of appeals.[6]

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the early 1970's, the BTU adjustment method for calculating gas value generally produced higher royalties than the net realization method. Furthermore, prior to the district court's decision, the Secretary maintained legitimate reservations whether the lease terms permitted dual accounting. Finally, it is not clear that requiring dual accounting, in every case, will be in the best long-term interest of the Tribe.

[5] There will, of course, be ample opportunity in future cases to examine the Tenth Circuit's interpretation of the United States' trust responsibilities to the Indian tribes. See, *e.g.*, *United States* v. *Cherokee Nation of Oklahoma*, cert. granted, No. 85-1940 (Oct. 6, 1986).

[6] Under the lease, the Tribe has the authority "that any lessor has under an oil and gas lease to enforce its terms and conditions and to so manage the property" (Pet. App. 7a). The Secretary clearly plays an

In our view, the meaning of the leases' royalty terms is open to legitimate debate. But we believe that they can be plausibly interpreted to require dual accounting and, at least in the present circumstances, we endorse that interpretation. The court of appeals' explanation (Pet. App. 45a-48a) is consistent with the language of the lease agreements. There is no conflict among the circuits concerning interpretation of the language at issue, and the court of appeals' interpretation may not be controlling in other Indian lease agreements executed under different circumstances. Thus, this contractual dispute does not warrant this Court's review.

2. Petitioners further argue that, despite their contractual obligations to the Tribe, the United States, rather than they, should pay any past royalties owed to the Tribe. Petitioners characterize themselves as "innocent" third parties (86-219 Pet. 16; 86-224 Pet. 28; 86-226 Pet. 25; see 86-225 Pet. 27) who have been forced to account for the Secretary's errors. This argument is plainly insubstantial.

Petitioners are sophisticated oil and gas producing companies that sought out leases from the Jicarilla Apache Tribe and agreed to open-ended leasing terms, accepting an element of commercial uncertainty in the pursuit of their economic self-interest. As we have already noted,

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important role in formulating lease terms and enforcing the lease agreements. However, as petitioners concede, "the Indians retain a significant role in making and supervising such leases" (86-225 Pet. 7). This Court has stated that "[w]hile the United States has exercised its supervisory authority over oil and gas leases in considerable detail, we find nothing in this regulatory scheme which would preclude [Indian lessors] from seeking judicial relief for an alleged violation of the lease." *Poafpybitty* v. *Skelly Oil Co.*, 390 U.S. 365, 373 (1968). Indeed, "there is nothing in the lease or regulations requiring the Indians to seek administrative action from the Government instead of instituting legal proceedings on their own" (*ibid.*). Accordingly, the litigation, as between the Tribe and petitioners, is no more than an action in contract to remedy violations of the lease terms.

those agreements can plausibly be read to require dual accounting. Furthermore, the agreements expressly leave the methodology for determining value, in part, to the Secretary's discretion.[7] And it is obviously petitioners, rather than the Secretary, who have enjoyed the quid pro quo for which additional royalty payments are due under the leases.

Nor is there otherwise any unfairness or impropriety in requiring petitioners to pay past royalties. As petitioners fully understand, their monthly submission of royalties and accompanying information is subject to correction after the Secretary's representative[8] has had an opportunity to make an independent audit. *Supron Energy*

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[7] Section 3(c) of the standard lease agreement provides (Pet. App. 379a-381a (emphasis added)):

> During the period of supervision, "value" for the purposes hereof may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered * * * at the time of production for the major portion of the oil of the same gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced and sold from the field where the leased lands are situated, and the actual volume of the marketable product less the content of foreign substances as determined by the oil and gas supervisor. The actual amount realized by the lessee from the sale of said products may, in the discretion of the Secretary, be deemed mere evidence of or conclusive evidence of such value. * * * *It is understood that in determining the value for royalty purposes of products * * * that are derived from treatment of gas, a reasonable allowance for the cost of manufacture shall be made, * * * and that royalty will be computed on the value of gas or casing-head gas, or on the products thereof * * *, whichever is the greater.*

Section 3(c) reflects Interior's present regulations governing determination of value. See 25 C.F.R. 211.13.

[8] Prior to 1983, the United States Geological Survey (USGS) was responsible for managing all federal and Indian oil and gas leases. The Minerals Management Service has succeeded the USGS as the responsible agency. See 25 C.F.R. Pts. 211, 212; 30 C.F.R. 206.100.

Corp., 46 I.B.L.A. 181, 189 (1980) (the Secretary bills lessees for royalties "on the basis of the information contained in monthly reports which they submitted, *subject to post audit*" (emphasis in original; reproduced at Pet. App. 187a)). Where, as here, lessees submitted royalty payments in a particular manner later found by the Secretary or a court to be inconsistent with the terms of the leases and regulations, the Secretary may demand payment of the deficiency. See *Atlantic Richfield Co.* v. *Hickel*, 432 F.2d 587, 591 (10th Cir. 1970); see also *Foote Mineral Co.*, 85 Interior Dec. 171, 181 (1978) ("the Government is not estopped from demanding royalty payments owed by lessees, even if it has accepted improper royalty payments in the past"), rev'd on other grounds, 654 F.2d 81 (Ct. Cl. 1981). Indeed, Congress, through the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. 1701 *et seq.*, has recognized that lease accounts are subject to correction and has directed the Secretary to "audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas and take appropriate actions to make additional collections or refunds as warranted" (30 U.S.C. 1711(c)(1)).[9]

In sum, the court of appeals' requirement that petitioners pay past royalties simply enforces petitioners' contractual obligations to the Tribe and does not merit this Court's review.

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[9] Congress has further instructed the Secretary to "aggressively carry out his trust responsibility in the administration of Indian oil and gas" (30 U.S.C. 1701(a)(4)), to "give priority to auditing those lease accounts identified by a State or Indian tribe as having significant potential for underpayment" (30 U.S.C. 1711(c)(1)) and to seek payment of interest on any underpayments from prior periods (30 U.S.C. 1721(a)).

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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